

FOUNDATIONAL ECONOMY

How public sector
accounting mimics
private sector reporting
and puts foundational
services at risk

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How Public sector accounting mimics private sector reporting:

Accounting for UK Private Finance Initiatives (PFI's) and risk to foundational public services

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Abstract

The adoption of International Financial Reporting Standards (IFRS) by private sector companies has been marketized in terms of how they will improve information transparency and generate decision useful information to investors. The adoption of IFRS for public sector reporting entities is about mimicking these private sector accounting standards subject to such adaptations as are necessary for the public sector and Public Financial Management (PFM). This paper focusses on the installation of IFRS (equivalent to International Public Sector Accounting Standards –IPSAS) into UK public sector reporting entities. Specifically, public sector reporting entities have entered into Public-Private Partnership's (PPP's) that include: Private Finance Initiative's (PFI's) and outsourcing contracts with private operators. These PFI and outsourcing contracts are typically accounted for as 'Service Concession Agreements' according to the International Financial Reporting Interpretations Committee (IFRIC 12) and its equivalent IPSAS (32). The UK Treasury's own interpretation of IFRIC 12 repatriates assets and liabilities attached to PFI and outsourcing contracts back on to the balance sheet(s) of public sector reporting entities. These assets are also reported at their 'fair value' and impairment tested even where these assets are non-cash generating. Asset impairments have the potential to undermine public sector reporting entity balance sheets when the value of reported assets falls below outstanding liabilities. Our case study on Greater Manchester Waste Disposal Authority (GMWDA) reveals how asset impairments have undermined the financial condition of its balance sheet. This generates uncertainty about the provision of essential waste management services for households.

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1. Introduction

In the UK the application of international financial reporting standards (IFRS) for private companies has now spread into public sector reporting entities after their adoption by Government from the financial year 2009-10. According to a briefing note issued by the UK House of Commons Scrutiny Unit:

Departments' resource accounts will adopt International Financial Reporting Standards (IFRSs) from 2009-10 onwards. This will affect the way PFI schemes, leases and financial instruments are accounted for¹.

The UK was at the forefront in terms of adopting IFRS to inform public sector accounting and improve public financial management (PFM). This installation of IFRS within the public sector adjusted the accounting process from a cash or modified cash based system of recording financial information towards an accruals approach to generate a statement of financial position. In the UK IFRS for the private sector are adapted to the needs of the public sector and are similar in nature to International Public Sector Accounting Standards (IPSAS). The motivation for the broader international project, driven by the International Public Sector Accounting Standards Board (IPSASB), is also to align public sector entity financial reporting with that of the private sector. The (IPSASB) revised IPSAS 1 is concerned with converging public sector accounting standards towards private sector standards (International Financial Reporting Standards – IFRS) to the extent appropriate.² According to Biondi (2014)

Concerning the public sector, the IPSAS are developed by the International Public Sector Accounting Standards Board (IPSASB), which is a standing committee of the International Federation of Accountants (IFAC). According to the IPSAS Board, “a key part of the IPSASB’s strategy is to converge the IPSASs with the IFRSs issued by the IASB (Biondi, Account. Econ. Law 2014; 4(3): 165–178).

With regards to IPSAS the: ‘General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees³

The installation of IFRS/IPSAS into the public sector has been ‘marketized’ in a similar way to reporting standards deployed in the private sector. There is the issue of transparency and provision of information that reveals how ‘public’ capital is invested and employed efficiently to deliver outputs. Disclosures about the

¹ <https://www.parliament.uk/documents/upload/ifrsbriefing.pdf>

² <https://www.ifac.org/system/files/publications/files/ipsas-1-presentation.pdf> ³ <https://www.ifac.org/system/files/publications/files/ipsas-1-presentation.pdf>

financial performance of a government or other public sector entity's and how this informs assessments about whether the public sector has employed resources economically and used them efficiently and effectively to achieve its service delivery objectives (IPSAS, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities)³. Thus financial information, it is argued, should be presented by public sector entities as if they were private sector business entities revealing: income statements, changes in cash, balance sheet assets and liabilities and net worth (changes in equity provided by taxpayers).

In this paper we explore the dysfunctional outcomes that arise when IFRS financial reporting regulations are adopted by UK public sector reporting entities that have entered into PFI and outsourcing arrangements with private sector operators. The policy arguments employed to support public sector outsourcing into the private sector are that private operators can generate value for money (VFM) and absorb financial risk. In this paper we argue that the interpretation of accounting standards governing 'service concession agreements' repatriates asset risk back on to public sector reporting entity balance sheets. The paradox is that the policy intentions of PFI and outsourcing rub up against accounting regulations that have the potential to generate contradictory outcomes that threaten the financial stability of public sector reporting entities and compromise the ongoing provision of essential public services.

Heald and Georgiou (2011) review the shift in accounting disclosure practice associated with Public Private Partnerships (PPP) which includes PFI and outsourcing contracts in the UK and summarise this as a migration from a 'risks and rewards' approach to that of establishing 'control'. This shift to 'control' is about determining whether a public sector reporting entity has control over assets and liabilities and if so how this informs the construction of consolidated accounts. Heald and Georgiou observe that a problem for public sector accounting was the absence of guidance in IFRS as to how PPP (or PFI) service concession assets should be accounted for by the client (government or public sector agency). International Financial Reporting Interpretations Committee 12 (IFRIC 12), is an interpretation rather than a standard but addresses how a private sector operator of PPP/PFI contract should account for a 'service concession contract' as either a financial or intangible asset. The question arose as to whether IFRIC 12 could be 'stretched' to provide the necessary guidance' for a public sector reporting entity, that is, the grantor of the contract (Heald and Georgiou 2011:232). Stretching the application of IFRIC 12 involved the UK Treasury issuing guidance that could be employed to establish whether the 'grantor' (the public sector client) had control over the use and residual interest in the assets of a PPP (or PFI) contract. Specifically, where the grantor of the contract (a) controls or regulates what services the operator must provide with the asset, to whom it must provide them,

³ <http://html5.epaperflip.com/?docid=9c3c49a0-9d06-49e1-b666-a5600137e9a9#page=1>

and at what price; and (b) controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement⁴. The grantor or public sector reporting entity must show these assets, even if they are non-cash generating, and corresponding liabilities on balance sheet.

Significantly, these assets are recorded at their 'fair value and according to the House of Commons Scrutiny Unit: This is the market price for which an asset could be exchanged or a liability settled. ...Whilst fair value gives users of the accounts more up to date information about the current value of Balance Sheet items, it could introduce volatility into the accounts which departments may need to explain, and in some cases it may be difficult to arrive at a valuation⁵ (House of Commons Scrutiny Unit, 2009: 3). Thus in certain circumstances the grantor (or public sector reporting entity) may find that it is exposed to asset valuation risk if the fair value of similar assets are fluctuating. The adoption of Fair Value Reporting (FVA) in the public sector also has significant ramifications for financial stability when balance sheets are marked to market (Haslam et al 2015). The inclusion of expected impairment losses on assets would have a detrimental impact on the financial stability of public sector reporting entities that have to record the adjusted value of PFI assets relative to liabilities on balance sheet. Central government or local government reporting entities that are exposed to asset write downs could find that they are reporting balance sheets with negative net worth because asset values are below outstanding liabilities. And, whilst both public and private sector reporting entities can operate with negative equity for a period of time this will prompt changes to resource management. Reported financial numbers are not simply neutral disclosures they also function as a control device and inform changes in behaviour (see Biondi 2011). For example, increasing taxes and /or reducing expenditures or a combination of both to repair a balance sheet.

This paper then turns to review the political arguments supporting PFI and the outsourcing of contracts to the private sector, specifically, how these arrangements are assumed to generate value for money and transfer financial risk to the private sector. Although Bowman et al 2015 have argued that some private sector companies that that have captured PFI and outsourcing contracts are financially unstable and this itself presents a significant risk to the continued provision of socially necessary services such as household waste management and elderly care. In this paper our concern is with the transfer of financial risk and exploring the contradictory logics generated by employing IFRS/IPSAS in the public sector sphere. Where these accounting standards not only impact upon the presentation of financial information but also the risk attached to the

⁴ http://www.ifac.org/system/files/publications/files/B8%20IPSAS_32.pdf

⁵ <https://www.parliament.uk/documents/upload/ifrsbriefing.pdf>

management of public sector resources. Biondi argues that accounting is about setting the 'rules of the game' and how these inform and support public policy. Accounting regulations are a framing device within which policy is assessed in relation to monetary accountability and how this establishes what is acceptable in terms of public administration (Biondi, 2014:173). Thus Biondi identifies the role of accounting as means by which policy is translated into financial representations that modify behaviour in ways that are anticipated by a policy initiative.

In this paper we argue that the process by which PFI and outsourcing arrangements are accounted for within extant IFRS/IPSAS operates within an accounting interpretative logic that, we argue, has the potential to generate 'paradox'. That is, public sector accounting standards could undermine rather than support the key policy intention of UK PFI and contractual outsourcing which was to displace financial risk from the public into the private sector. The dysfunctional and contradictory logic(s) operating between accounting regulations and the policy objectives of PFI contracts are illustrated with a specific case: The Greater Manchester Waste Authority (GMWA) which has outsourced its household waste management services to a private provider Viridor. The decision governing what type of assets are recorded by the grantor of a PFI contract (public sector reporting entity) and the operator (private sector firm) results from interpretations of IFRIC 12 (and IPSAS 32). IFRIC 12 itself determines how the operator of a service concession agreement records the financial (or intangible asset) on balance sheet. Whilst the UK Treasury Financial Reporting Manual takes a 'mirror' interpretation of IFRIC12 to determine whether the assets attached to a service concession agreement are to be recorded on the public sector reporting entity accounts as property, plant and equipment. These assets reported on the public sector reporting entity accounts are then subject to fair value impairment tests even though they do not directly generate cash for a public-sector reporting entity. These assets are *de facto* treated as if they were cash generating because fair value impairment tests assess the value of these assets relative to other similar assets. The risk to public sector reporting entities arises not only when asset values are written but outstanding liabilities remain thus forcing the public sector reporting entity into negative net worth. The managerial response will be to try and repair the balance sheet with tax increases or a reduction in spending or a combination of both to stabilise the financial position.

2. Policy arguments for PFI contracts and outsourcing

The Private Finance Initiative (PFI) was introduced in the UK in the early 1990s, and has continued to expand such that the value of PFI projects amounts to £56.5bn and total future unitary charges on these projects roughly £222.2b (HM Treasury, 2016)

Table 1: Current UK PFI Projects

Department	Capital value (£ million)	Unitary charge payments: 2015/16 (£ million)	Total unitary charge payments: 2015/16 onwards (£ million)	Number of PFI projects
Department of Health	12,083	2,025	66,315	123
<i>Of which NHS</i>	<i>11,845</i>	<i>1,961</i>	<i>64,944</i>	<i>105</i>
Ministry of Defence	9,043	1,838	31,871	41
Department for Transport	7,879	1,238	27,592	62
Department for Education	7,800	1,082	22,254	168
Scottish Government	5,690	985	22,284	83
Other departments	14,060	3,299	51,878	251
Total	56,554	10,467	222,194	728

Notes: NHS figures are for all projects listed under the Department of Health with the exception of social care projects

Source:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504374/PFI_PF2_projects_2015_summary_data.pdf

With a PFI scheme the capital value of assets constructed and managed by a private operator are financed by central or local government reporting entity by payments of a 'unitary charge' that includes a capital repayment element and also a service component attached to operating and maintaining assets. The arguments for PFI schemes are summarised in table 2 but centrally include a displacement of risk in terms of: responsibility for constructing assets, cost control and financing arrangements⁶ (House of Commons, 2015)

Table 2: Main arguments for PFI contracts

Delivery of assets that might be difficult to finance conventionally
Encourages new private sector industry
Allocates risk to those that are best able to manage these risks
Promotes cost efficiency and delivery of assets to time and price expectations
Banks providing finance will conduct due diligence over contracts
Private providers encouraged to maintain assets for their whole life
Incentives and penalties can be employed to maintain value for money from contracts

PFI costs and benefits: Briefing paper No 6007, May 2015 (Summary of main points)

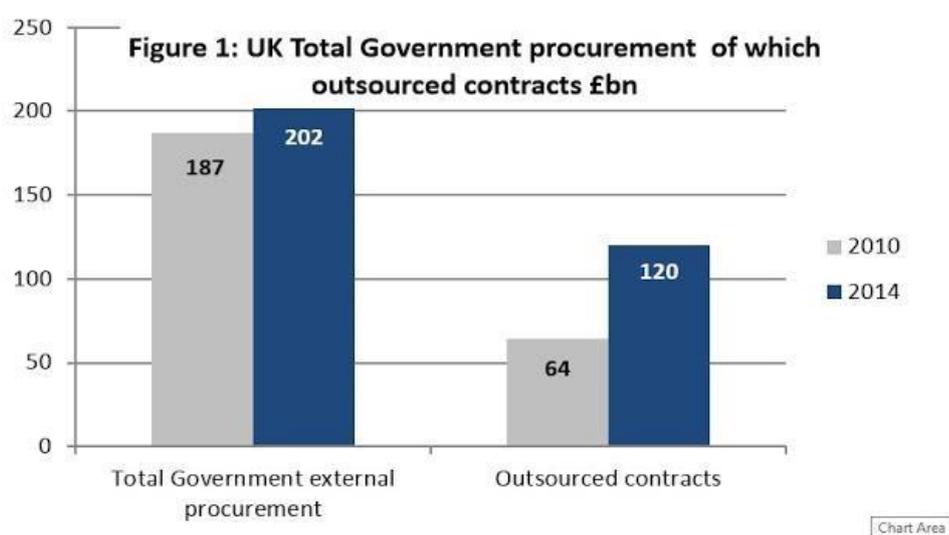
⁶ file:///C:/Users/BSW268/Downloads/SN06007.pdf

A key element justifying the adoption of PFI schemes was that of transferring risk and responsibility to the private sector.

PFI was introduced to deliver high quality assets and services and better value for money for the public sector. It aimed to do this through the transfer of appropriate risks to the private sector, a clear focus on the whole of life costs of projects and an innovative approach to service delivery. The payment for PFI projects was structured to ensure that the public sector only paid for the services that were delivered⁷ (HM Treasury, 2012).

2.1 Public sector outsourcing contracts

The outsourcing relationship between central and local government agencies and private sector counterparties is mediated through the 'outsourcing contract'. These contracts represent a form of decentralised, capillary power capable of reinforcing 'governmentality' in terms the state can exercise indirect control at a distance. In recent years outsourcing contracts with the private sector have increased as a share of total government external procurement from 34% to roughly 60% (see figure 1).



Source: Haslam⁸

Note: Procurement is total spend on external supplies and services by government departments and outsourced contracts are the proportion of external procurement that is estimated to be spent outsourcing public services⁹.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205112/pf2_infrastructure_new_approach_to_public_private_partnerships_051212.pdf

⁸ <http://qmulcgl.blogspot.co.uk/2015/11/public-sector-outsourcing.html>

⁹ <https://www.ft.com/content/244f0bd8-eccb-11e4-a81a-00144feab7de>

Contracts for public services are bundled up within large national and multi-national firms including private equity partnerships. These companies include both specialist providers such as with household waste management services and conglomerates which manage a diverse range of public sector contracts and services. The outsourcing revolution has given rise to the large outsourcing firm, which now constitutes a new governing institution that has control over the delivery of essential public services. The policy argument driving the displacement of public services into the private sector is primarily informed by the displacement of risk. According to a House of Commons Research Paper (HC 01/117: 2001): With the PFI, as with many other types of PPPs, value for money is achieved through the transfer of risk to the private sector, which is perceived to have an advantage in handling risk (HC, 2001:28). In the next section of this paper we argue that the accounting logics attached to the interpretation of IFRS/IPSAS for public sector reporting entities have the potential to undermine the justification for PFI contracts, namely, that financial risk would be transferred from the public into the private sector.

3. Installing IFRS (IPSAS) into public sector reporting entities

The UK public sector applies accounting guidance that is broadly consistent with IPSAS, that is, the accounts of the central government departments and public sector reporting entities have been produced using IFRS as adopted by the European Union (EU) from 2009/10. The marketization of IFRS/IPSAS is promoted in terms of how this system of accounting enhances: information transparency, comparability (through convergence), and accountability over the stewardship of public financial resources when accruals based accounting is employed.

The IPSASB's objective is to serve the public interest by developing high-quality accounting standards and other material for use by public sector entities around the world in the preparation of general purpose financial reports. This is intended to enhance the quality and transparency of public sector financial reporting by providing better information for public sector financial management, accountability and decision making¹⁰.

A second imperative is to promote a global convergence of public sector reporting practice

...the IPSASB supports the convergence of international and national public sector accounting standards and the convergence of accounting and statistical bases of financial reporting where appropriate.¹¹

A third that of installing 'accruals' based financial reporting because this, it is argued enhances 'accountability'.

Financial statements prepared under the accrual basis of accounting inform users of those statements of past transactions involving the payment and receipt of cash during the reporting period, obligations to pay cash or sacrifice other resources of the entity in the future and the resources of the entity at the reporting date. Therefore, they provide information about past transactions and other events that

¹⁰ <https://www.ifac.org/node/1503/terms-reference>

¹¹ <https://www.ifac.org/node/1503/terms-reference>

is more useful to users for accountability purposes and as input for decision making than is information provided by the cash basis or other bases of accounting and financial reporting¹² (IPSASB, 2012). In broad terms IFRS and IPSAS accounting standards employed by public sector reporting entities are now very much aligned.

Many of the IPSASs currently on issue are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector. The IPSASB's strategy also includes maintaining the alignment of IPSASs with IFRSs where appropriate for the public sector (IPSASB, 2012)

Of specific concern in this paper is the accounting treatment of 'service concession agreements' as prescribed within IFRIC 12 (IPSAS 32) and applied to situations where government agencies are acting as the grantor of service concession contracts to a private sector operator that builds infrastructure and operates these assets.

3.1 Accounting for Service Concession Agreements IFRIC 12 (or IPSAS 32)

Deloitte (2011) observe that the IASB published IFRIC 12 on Service Concession Arrangements in 2006 where: 'Service concession arrangements are arrangements whereby a government or other body ('the grantor') grants contracts for the supply of public services, such as roads, energy distribution, prisons, or hospitals, to a private sector entity ('the operator'). This is often referred to as a 'public-to-private' arrangement' (Deloitte, 2011:7). The nature of PFI contracts and outsourcing arrangements established by the UK Central Government and Local Authorities often involves the construction and operation of assets that the grantor (government agency) regulates and controls through a specific service level agreement and / or is able to take ownership of the asset at the end of a specified contractual time period. The rules governing how to report service concession agreement assets within the public sector reporting entity accounts are outlined in interpretations contained within the UK HM Treasury Financial Reporting Manual and are extracted below:

Where there is infrastructure, whether previously owned by the contractor or the grantor, or constructed or acquired from a third party for the purpose of the service arrangement, and the grantor:

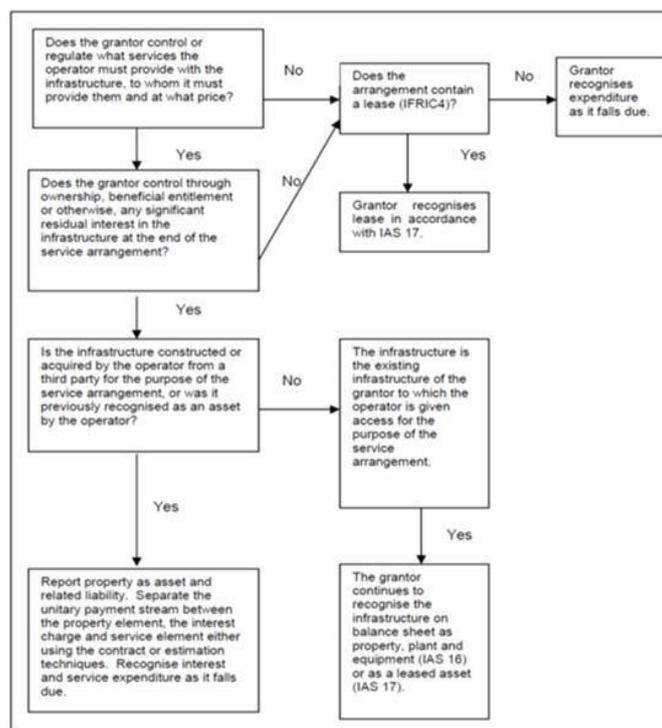
- a) Controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them and at what price; and
- b) Controls through beneficial entitlement or otherwise, any significant residual interest in the infrastructure at the end of the term of the arrangement (or there is no residual interest). Then the

¹² https://www.ifac.org/system/files/publications/files/CP_Conceptual_Framework_for_G_P_Financial_Reporting.pdf

PPP arrangement or PFI contract is a service concession within the meaning of IFRIC 12 from the grantor's viewpoint.

(UK HM Treasury, 2016: 45)

Figure 1 Flowchart of accounting for PPP arrangements



UK HM Treasury, 2016: 44

The flowchart in figure 1 and extracted from the UK HM Treasury financial manual is employed to ascertain whether assets attached to a service level agreement are under the control of a public sector reporting entity. If public sector control over the service level agreement is established or beneficial ownership identified in the PFI contract the assets attached to the service concession agreement will need to be recorded as property, plant and equipment assets in the public sector reporting entity accounts with commensurate liabilities.

Standard PFI schemes are service concessions within the scope of IFRIC 12 and public sector accounting rules state that public bodies must recognise the infrastructure (together with the related liability to pay for it) on their balance sheets from the date the services commence¹³

¹³ <http://www.accountingweb.co.uk/business/financial-reporting/expert-guide-accounting-for-pfi>

Where the grantor of the PFI contract recognises the infrastructure as a non-current asset it must now also value these assets in the same way as other non-current assets of that generic type. Specifically Local Authorities should measure their assets and liabilities and provide disclosures in accordance with IFRS 13 Fair Value Measurement. Technically these assets are not cash generative for the public-sector reporting entity but they are subject to an impairment test and may need to be written down. Whilst the private sector operator of these assets as part of the 'service concession' will recognise these as financial or intangible assets upon which future income and expenses will be incurred and a cash flow generated.

The adoption of IFRS accounting standards for 'service concession agreements' not only brings back asset values on to a public sector reporting entity balance sheet but IFRS 13 imports fair value asset impairment risks. This represents a significant challenge for public sector reporting entities which are now required to absorb speculative asset values into their balance sheets and this can amplify financial instability (see Haslam et al., 2012, 2015). To explore these issues in more detail we now turn to a specific case study on Greater Manchester Waste Disposal Authority (GMWDA).

4. The Greater Manchester Waste Disposal Authority (GMWDA)

The Greater Manchester Waste Disposal Authority GMWDA is the largest of six statutory waste disposal authorities created under the UK Local Government Act (1985) and was formed in 1986 on the demise of Greater Manchester Metropolitan County Council. According to the latest final report and accounts: GMWDA is England's biggest waste disposal authority and deals with over 1 million tonnes of waste each year and is equivalent roughly 4% of England's local authority collected waste (LACW). The Authority provides waste disposal services to nine Greater Manchester Authorities serving over one million households and a population of above 2.3 million¹⁴. The Authority prepares its financial accounts in accordance with regulated accounting practices and comprise the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and the Service Reporting Code of Practice for Local Authorities 2015/16 (SeRCOP), supported by International Financial Reporting Standards (IFRS).

The annual report and accounts produced by the GMWDA recognise that it controls the services provided under the Recycling and Waste Management Contract with Viridor Laing (Greater Manchester) Ltd and that it is also entitled to the residual value of the facilities at the end of the contract. This means that GMWDA reports

¹⁴ <http://www.gmwda.gov.uk/clientfiles/File/Statement%20of%20Accounts%20201516%20Final.pdf>

the value of property, plant and equipment attached to its PFI outsourcing contract with Viridor on its balance sheet.

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Authority is deemed to control the services that are provided under its PFI schemes, located within the conurbation and as ownership of the property, plant and equipment will pass to the Authority at the end of the Contract for no additional charge, the Authority carries the assets used under the Contract on its Balance Sheet as part of Property, Plant and Equipment (GMWDA, AR 201415:48)

These assets held on balance sheet are subject to fair value impairment tests which involves benchmarking the value of property, plant and equipment employed in waste management contracts with similar assets. Impairment losses are firstly charged to the revaluation reserve and if there is any shortfall within this reserve the reduced value of the asset will be charged to comprehensive income and expenditure.

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall. Where impairment losses are identified, they are accounted for as follows:

- a] Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains).
- b] Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement (GMWDA , AR 2012-13:46)

Table 3 summarises some of the key operating financials reported by the GMWDA in the balance sheet and notes to the accounts that reveal the extent to which asset values have become impaired. For the period 2012 onwards and after the adoption of IFRS reporting standards the GMWDA reports an accumulated fair value asset impairment of £208 million. To put the scale of these asset impairments into perspective they are equivalent to over one year's worth of levy (tax) charged to local taxpaying households for household waste management.

Table 3: GMWDA Summary Financials £mill

	Property Plant and Equipment net of impairments	Longterm liabilities	Net Assets	Asset Impairments charged against income	Household funding levy each year
2012	238.0	299.8	-33.4	(42.8)	124.7

2013	252.8	343.8	-120.5	(97.8)	145.5
2014	274.9	403.8	-117.7	(48.7)	160.7
2015	267.2	392.5	-105.6	(1.1)	166.5
2016	258.7	368.5	-115.0	(17.7)	164.0

Source: GMWDA financial reports, various years <http://www.gmwda.gov.uk/publications/finance>

In the GMWDA Statement of Accounts 2012/13 it is noted that:

Messrs GVA Grimley Ltd carries out all land and buildings, infrastructure and PFI asset revaluations on the Authority's behalf, in accordance with the provisions of the professional standards of the Royal Institute of Chartered Surveyors. The significant assumption applied by the valuer in estimating fair values is that the property would be sold as part of the continuing waste management contract.

GMWDA Annual Report (2012/13:59)

This disclosure reveals that the assets held on balance sheet, whilst not directly cash generative, are estimated at their fair value by benchmarking these assets if sold as part of a continuing waste management contract. Obviously, during a period of financial austerity the earnings from these assets from any new or continuing waste management contract would be reduced and therefore also the market valuation attached to these assets. Local Authorities have been subjected to significant real reductions in their funding budgets as Central Government austerity initiatives take hold. A National Audit Office (NAO, 2014) report 'The impact of funding reductions on local authorities'¹⁵ reveals that overall funding for Local Authorities has dropped (in real terms) by 37 per cent over the period 2011-2016 (NAO, 2014:4). Table 4 below reveals the percentage reduction in funding for household waste and environment related budgets at Local Authority level averaging 13 percent.

Table 4: UK Local Authority Changes in Real Spending (%)

2010/11 to 2014/15				
Environment and Regulatory	Street Cleaning	Waste Management	Recycling	
-17.9	-13.2	-11.7	-9.4	

Source: NAO (2014) 'The impact of funding reductions on local authorities' (2014:32)

These austerity measures impact negatively, by default, on the earnings capacity of Local Authority assets and hence their fair value forcing public sector reporting entities to report negative net worth as asset values fall below outstanding liabilities. According to CIPFA: 'A number of authorities are already in a negative net worth position. This doesn't mean they are not a going concern. Local authorities are required to operate within the framework set out in the Local Government Acts. When an authority has a negative net worth, this indicates

¹⁵ <https://www.nao.org.uk/wp-content/uploads/2014/11/Impact-of-funding-reductions-on-local-authorities.pdf>

that future taxpayers (whether through Council Tax or indirectly through government grants) will be funding some of the cost of providing services in the past¹⁶ (CIPFA: Technical Enquiry 2017 download).

Managerial response(s) deployed to repair GMWDA's balance sheet have involved a combination of raising local taxes and/or trying to reducing expenditures. Firstly the GMWDA has increased the levy charged to local households by 30 percent since 2012 for the collection and management of household waste. According to Materials Recycling World these costs to the local taxpayer are set to increase by another 16-18 percent in the next two years.

The authority set its 2016-17 budget on 12 February 2016 and, in so doing, noted the potential requirement for a 9.6% increase in levy in 2017-18 (due in part to the phasing out of the use of reserves) followed by a 7.6% increase in 2018-19 (when no reserves would be available to support the levy). After that time increases would become linked to inflation once more. (Materials Recycling World, 2016)

GMWDA is currently seeking to reduce the operating costs of its contract with the private provider Viridor and, according to LetsRecycle.com, a pre-close trading update published on 9 December observes that: 'The Greater Manchester Waste Disposal Authority ("GMWDA") has indicated that it is not satisfied with the current status of the VL (Viridor Laing) Co project and it continues to seek significant cost savings and efficiencies' (Lets Recycle.com 2016)¹⁷. Commentators have further observed that GMWDA needs to identify annual contract savings of £21 million to deliver a zero increase in the levy to households in 2017 to 2018 (Materials Recycling World, 2016)¹⁸. This saving, if agreed, would be equivalent to reducing the PFI service charge paid to Viridor by fifty percent and clearly represents an unrealistic adjustment to the contractual payments for services provided.

The accounting logic governing service level agreements has the potential to undermine the financial viability of local authority reporting entities that are operating PFI outsourcing contracts. Public sector reporting entities operating these 'service concession agreements' must report assets 'on balance sheet' and periodically test these for impairment. GMWDA's response to its own asset impairments and reported negative net worth on its balance sheet has been to press for higher levies on local households and renegotiations with the provider Viridor over service costs.

¹⁶ <file:///C:/Users/BSW268/Downloads/TES%20FAQ%20Negative%20Networth.pdf>

¹⁷ <http://www.letsrecycle.com/news/latest-news/greater-manchester-waste-contract-under-financial-pressure/>

¹⁸ <https://www.mrw.co.uk/latest/englands-largest-waste-authority-under-cash-pressure/10015901.article>

5.0 Summary and discussion

Ian Carruthers chair of the International Public Sector Accounting Standards Board (IPSASB) has argued for convergence towards IPSAS on the basis that they provide a number of benefits supporting Public Financial Management (PFM). First, they provide a complete financial overview of a reporting entity; secondly information is reliable because IPSAS formatted financial information enhances planning and decision making; thirdly IPSAS are set by an independent global standard setter and this reinforces credibility and comparability. This marketization of IFRS or IPSAS for public sector financial reporting is about mimicking private sector accounting practice. The adoption of IFRS into the public sector are evaluated in terms of how these accounting regulations generate benefits that exceed their costs where: benefits are represented as the contribution to 'decision usefulness and management of financial resources' and costs the 'expense of installing' a new accounting system (Connolly and Ward, 2013).

Biondi (2014) observes that accounting regulations are not simply a neutral representation of information to stakeholders about the stewardship of resources. Rather, the financial numbers are also a control device that can have an impact on society because, as Biondi argues, changes to accounting disclosures are often conjoined with policy initiatives that seek to modify behaviour. In this paper we explore how the interpretation of accounting regulations associated with PFI service concession agreements have the potential to generate paradoxical and unintended consequences for the provision of essential foundational economy public services.

There has been a considerable growth in the use of PFI as the public sector outsources service concession contracts for the delivery of social services, healthcare, education and other critical foundational community services. The UK government's PFI and outsourcing policy is supported by narratives about how private providers can improve the management of 'public' resources and absorb financial risk on behalf of central and local government agencies. The argument developed in this paper is that the presentation of financial information by public sector reporting entities not only mimics private sector practice it can also generate dysfunctional outcomes that have the potential to undermine the provision of essential public services.

The UK Treasury interpretation of IFRIC 12 on accounting for 'service concession arrangements' constructs a set of decision rules about when the grantor (public sector reporting entity) should report assets attached to

a service concession on balance sheet. These rules involve establishing whether the grantor of the service concession has 'control' over the services provided or takes ultimate beneficial ownership of these assets. With regards to PFI and outsourcing contracts the public sector 'grantor' will often be able to regulate or control the service provision within the contract and also take ultimate ownership of any assets developed to deliver the contract at some future date.

This 'mirror' interpretation of IFRIC 12 serves to bring assets back on to the balance sheet of public sector reporting entities. Furthermore, even though these assets are not directly cash generating (and hence subject to discounted cash flow valuations) they are made subject to fair value assessments by benchmarking the value of these assets to similar assets that are either directly generating cash or being bought and sold following IFRS 13 'Fair Value Measurement' recommendations. At GMWDA fair value asset impairments have damaged the balance sheet forcing it into negative net worth. The GMWDA managerial response has been to increase the levy charged to local households for the provision of household waste management services and/or reduce the service costs paid to the private contractor.

The bottom line is that essential public services are now being accounted for in ways that mimic private sector financial reporting practice. Our argument is that the adoption of IFRS (and equivalent IPSAS) will import asset impairment risks onto the financial statements of public sector reporting entities. The adoption of IFRS is having unintended consequences on the financial viability and stability of public sector reporting entities that are responsible for providing essential foundational economy public services.

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